

**Alabama Trust Fund
Board of Trustees Meeting
May 21, 2015
State Capitol, N-202**

Pursuant to public notice, a meeting of the Alabama Trust Fund Board of Trustees was held on May 21, 2015. The meeting was called to order at 10:00 AM by Secretary Boozer. The roll was called by Secretary Boozer and recorded as follows with a quorum present.

Present:

Mr. Bill Newton, Vice Chair
Mr. Young Boozer, Secretary
Mr. Daniel Hughes
Mr. Edgar Pruitt
Mr. Guice Slawson, Jr
Dr. Sandra Sims-deGraffenried

Absent:

Governor Robert Bentley, Chair
Mr. Sam Upchurch
Mr. Rich Bielen

Mr. Boozer welcomed newly appointed board member Mr. Edgar Pruitt. He noted that Mr. Pruitt had recently been appointed by Governor Bentley.

The first decision item was to review and approval of the minutes of February 19, 2015. Upon motion made by Dr. Sims-deGraffenried, and a second by Mr. Guice Slawson, the reading of the minutes was dispensed and the minutes were unanimously approved as presented.

Mr. Boozer reviewed the quarterly financial reports. He noted assets of \$2.79 billion were slightly lower than at December 31, 2014. Quarterly revenues of \$50.4 million were offset with quarterly distributions of \$67.7 million. Royalty payments were decreasing at \$16.2 million when compared to the same quarter the year before. Mr. Boozer noted that the royalty payments should continue to decline over the next couple of quarters due to the decreases in price and production. Other reports were reviewed.

Ms. West presented the quarterly investment performance measurement report and market overview. She noted first quarter GDP growth was disappointing at only 0.2%. This was primarily because of the drop in oil prices and a strong US dollar. She noted that consumer spending and sentiment was still strong. Ms. West also noted the domestic equity and fixed income markets were doing well with the S&P 500 index returning 12.73% for the year and the Barclay's Aggregate index returning 1.61% for the quarter and 5.72% for the year.

In comparing the actual ATF asset allocation to the target asset allocation, Ms. West noted a slight overweight to domestic equity, but still within the rebalancing ranges. The quarterly total fund return of 2.83 % is above the target return of 2.31% with the large cap and small cap equity managers adding value. The one year total fund return of 6.75% is 0.30% above the benchmark return. The manager effect was the driver behind the outperformance over the 3-year period, with the fund up 8.54% versus the target return of 7.86%. Total invested assets increased slightly from December as a result of an investment return of \$70.9 million offsetting \$51 million in draw outs during the quarter.

Ms. West reviewed the quarterly returns. Smith Group continued to struggle for another quarter; however, they have outperformed since inception. Small cap manager Atlanta Capital outperformed its respective benchmark by over 2%. GMO had a strong quarter outperforming the benchmark by almost 3%, but Wells Capital continued to underperform when compared against its benchmark. Sterne Agee was the only fixed income manager to underperform the benchmark for the quarter. Under real estate, it was noted that Angelo Gordon had 1-year return of almost 22%.

Ms. West recommended that Wells Cap be placed on the watch list and that the RFP process be started to hire an additional international emerging markets manager to split that asset allocation between the two managers. Upon motion made by Mr. Boozer, and a second by Mr. Hughes, the recommendation was unanimously approved.

Ms. West reviewed the April flash report noting that all international equity managers had positive returns for the month. The fund's total return of \$25.6 million was offset by \$78.5 million in payouts. This left the total fund just above \$2.5 billion. She also noted that CS McKee had a very strong month, but Smith Group continued to struggle.

Under decision items, Ms. West reminded the Board that Callan conducted an onsite review of Sterne Agee due to performance issues and organization concerns. She introduced Mr. Brett Cornwell, Fixed Income Consultant at Callan & Associates. Mr. Cornwell conducted the onsite review of Sterne Agee on March 25, 2015. Mr. Cornwell started by reviewing the organization as a whole. He noted that the former CEO was terminated in May 2014 and that the former CEO is currently being investigated by the US Department of Justice for misappropriation of assets. Mr. Cornwell stated that these events make him question whether appropriate policies and procedures are in place to prevent these types of actions. He also noted that Sterne is currently involved in a lawsuit with its former CFO. He informed the board that in February 2015, Stifel Financial Corp began the process of buying Sterne Agee. He stated that there were concerns with the future of Sterne's fixed income business given the overlap of products offered by Stifel. Mr. Cornwell then discussed Sterne's management of ATF's portfolio. While Sterne's investments are considered high quality as far as credit risk, there appears to be significant structure risk. Sterne was hired to be core domestic fixed income manager and appears to not be performing and making investments within that scope. The risks being assumed were also not leading to increased returns when compared to the benchmark. It was noted that Sterne over time has underperformed its peer group over most periods. Mr. Cornwell also noted that the underperformance could be caused by lack of dedicated resources. Mr. Cornwell stated that each of these concerns in isolation may not be a reason for termination, but in aggregate, all of these issues support a recommendation for termination. Upon motion made by Mr. Boozer, and a second by Dr. Sims-deGraffenried, the recommendation to terminate Sterne Agee was unanimously approved.

Ms. West recommended that assets be transitioned to another fixed income manager that is already managing assets for the Board. Mr. Newton asked if there was any Alabama firm that had the capability to handle the assets. Ms. West stated that Regions was the only local manager that she was aware of that could handle an institutional client the size of the ATF. It was noted that the Board already has a relationship with Regions. Mr. Boozer made the recommendation that Callan request proposals from Regions, Aberdeen, and Western Asset. Mr. Newton recommended that the Board delegate the decision to the investment committee since the next board meeting wasn't for three months and the Board would review and ratify the decision at its next meeting. Upon motion made by Mr. Newton, and a second by Dr. Sims-deGraffenried, the recommendations were unanimously approved.

The next decision item was the review of the large cap equity structure for the ATF. Ms. West noted that the ATF currently has one passive large cap manager, RSA, and two active large cap managers, Intech, and CS McKee. She noted that the benchmark for the active large cap equity managers was the Russell 1000 index. She stated that in recent years the index has been very difficult for active managers to beat. She noted that RSA manages a passive S&P 500 index fund and that over time the Russell 1000 index has outperformed the S&P 500. She reviewed the performance for the three managers for the Board. She presented to the Board three scenarios. The first was to maintain the current structure. The second was to move the entire large cap portfolio to a passive management strategy and replace the two active managers with one Russell 1000 index fund manager. The third was to retain the active managers and replace

the current S&P 500 index fund with a Russell 1000 index fund. Secretary Boozer was asked to determine whether RSA could provide a Russell 1000 index fund. He stated he would speak with RSA and report his findings back to the board at the August meeting.

Under informational items Ms. West noted that the responses from the Global Manager Equity search were being reviewed and that they should have a group of 6 or so for the investment committee to review prior to the next meeting.

The next order of business was to review the investment performance of the County & Municipal Government Capital Improvement Trust Fund ("CMT"). The full quarterly investment report was emailed to the Board, and summary information reviewed at the meeting. Ms. West noted that the assets of \$479 million recorded a total quarterly fund return of a 2.21 % to the benchmark of 2.31 %. The underperformance was primarily a result of the asset allocating deducting 10 bps, primarily from the real estate sector not being fully funded. The 1- year total fund return is 6.12%. The April flash report was also reviewed. Ms. West noted that the portfolio had \$6.8 million in realized and unrealized losses for the month but that was offset by the yearly drawdown of \$21.2 million.

There being no further business, the meeting was adjourned at approximately 11:40 am.

Bill Newton, Vice-Chair

Young Boozer, Secretary